FOOD PRICES AND INFLATION: PERSPECTIVES AND PROSPECTS

I appreciate the opportunity to be here today to discuss food prices and inflation and to provide some insights regarding the Department's philosophy on food prices and food policy.

I am also pleased to participate in this meeting. The Department of Agriculture is a major source and a major user of statistics. Our responsibilities exceed far beyond the food and agriculture sector but today, I will concentrate on this sector. Within the food and agriculture sector we are responsible for the collection of commodity price data, but we rely on the Department of Labor for certain wholesale and retail food price information. We have had a good working relationship with the Labor Department and expect that to continue.

When Abraham Lincoln founded the Department of Agriculture in 1862, he called it the "People's Department." We have a responsibility to all the people with respect to information on the state of world and U.S. food and agriculture. This includes maintenance of historic data and the assessment of the outlook. In the implementation of a national food policy, we are committed to all the people. That policy, we believe, must have as its basic premise, the assurance that there will continue to be an adequate, safe, wholesome, nutritionally-balanced food supply available to everyone in this country, at prices that are fair to producers and consumers at home or abroad.

We are concerned that food prices be "reasonable." However, this Administration does not support the concept of a cheap food policy. Unless the farm and the food marketing sectors are allowed to remain economically

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Remarks by Howard W. Hjort, Director of Economics, Policy Analysis and Budget, before the Federal Statistics Users' Conference, Stouffer's Nat'l Center Hotel, Arlington, Va., October 12, 1978.

viable, the most basic element of our food policy--an adequate food supply--will not be satisfied.

My remarks today relate to food price statistics at USDA. First, I will discuss the role of food in the Consumer Price Index (CPI). Then I will review the historical relationship between food price increases and overall inflation. Third, I will address the factors that have influenced food prices most significantly in 1978. Given that background, I will make a few remarks about the probable food price setting for 1979.

Food Prices: Measurement and Importance

It is the Department of Labor--not USDA--that actually monitors retail food prices. On a monthly basis, price data on a wide variety of food items are collected as a part of the larger effort to develop the monthly Consumer Price Index. It used to be this information was compiled only during the first week of every month. But since the beginning of this year, the price collection process has been distributed over the entire month. This change has made the food price index release more timely, reliable and thus, more useful.

Once prices are collected, changes are calculated and weighted by the relative importance of a "typical" food budget. They are then computed into the CPI.

Food ranks third in importance of expenditures in the CPI, comprising 17.713 percent of the overall index. Only shelter, weighted at 30 percent, and transportation, weighted at slightly more than 18 percent, are of greater importance in the CPI.

What this means is that in 1973-74, the years of the last survey for price weighting purposes, about 18 percent of the consumer dollar went for

food. Consequently, a 10-percent increase in food prices in any one year would result in an increase of 1.8 points in the CPI, assuming that the prices of all other expenditures were unchanged.

The food category is divided into two major components: food-at-home, valued at 12.2 percent in the CPI, and food-away-from-home, valued at 5.5 percent. The relative importance of the latter rises with each periodic update of the weights.

The importance of various commodity categories are measured, based upon the food spending pattern of the "average" U.S. household in 1973 and 1974 (table 1).

Meat has the greatest expenditure weight: 32 percent. Thus, if meat prices alone rise 10 percent in one year, the food-at-home index increases by 3.2 percent. When meat prices rise by 20 percent as they have this year, they will account for about 6½ percent of the overall food-at-home increase.

Fruits and vegetables are the second greatest expenditure, making up 14.4 percent of the food-at-home index. Other important product groups include dairy products at about 13 percent; cereal and bakery products, about 12½ percent. Sugars and sweeteners and fats and oils are relatively less important as product groups; together they represent about 6½ percent of food-at-home purchases.

Increasingly important but often unrecognized in their impact on food prices are non-alcoholic beverages--coffee, tea and soft drinks. They comprise 12.4 percent of the food-at-home index. Prepared foods account for 8.5 percent. The relative importance of foods in these two categories increased substantially when the CPI was revised last January.

In any reference to the Consumer Price Estimate, it is fundamental to remember that the CPI for food is a price index. It is not a cost of

Table 1.--Relative Importance of Food Groups in the Consumer Price Index, December 1977

Item	Consumer Price Index--All Urban	
	CPI	Food at home
	Percent	
Food	17.718	
Food at home	12.235	100.00
Cereals and bakery products	1.530	12.51
Meats, poultry, fish & eggs	3.943	32.22
Dairy products	1.654	13.52
Fruits and vegetables	1.759	14.38
Sugars and sweets	0.435	3.56
Fats and oils	0.360	2.94
Nonalcoholic beverages	1.513	12.36
Other prepared foods	1.041	8.51
Food away from home	5.483	

Source: U.S. Department of Labor, Bureau of Labor Statistics.

living index. Because consumers adjust the quantities of products they buy as prices vary, it is unlikely that increases in the food CPI imply equivalent percentage inclusions in weekly food expenditures.

Regardless, because food purchases are made weekly and because changes in food prices are highly visible, consumers are especially sensitive to price movements. And, whether justified or not, changes in food prices are often used by many as a psychological bellweather to signal the strength of inflationary pressures in the general economy.

Let's look at the record.

Food Prices and Inflation

In 17 years since 1950, retail food prices contributed less than one percentage point to the overall rate of inflation (table 2). In fact, in four of those years--1953, 1954, 1955 and 1959--food prices actually reduced the overall rate of inflation in the economy.

It is important to note, however, that four of the largest year-to-year percentage changes in retail food prices have occurred since 1972. Only once since then--in 1976--have food price increases contributed less than one percentage point to the overall inflation rate.

Food prices in themselves are also affected by inflation. The impacts of higher input prices since 1965 cannot be ignored. Marketing costs today account for 70 percent of the retail cost of our food. Higher energy costs have contributed significantly to the increases in recent years. For example, from September 1973 to May 1974, food prices increased 17.9 percent while non-food commodities rose 11.1 percent. Obviously, this rise was much less steep than the 62.1 percent price rise for energy products during the same time period.

In addition, the recent volatility in prices of foreign foods and fish has had a significant effect. In December 1977, for example, these

foods accounted for 19 percent of the food-at-home index. This compares with an 11 percent weight of about 10 years ago. Since 1970, prices for these products have increased 145 percent; retail prices for domestically-produced farm foods, on the other hand, have risen 58 percent. We especially felt the impact of higher prices for foreign foods and fish in 1977 when food prices increased 6.3 percent, largely due to higher coffee prices.

These data clearly indicate that, while food prices have contributed to the general inflationary pressures in some years, food prices have not been consistent nor prominent contributors to the overall inflation problem.

Factors Influencing Food Prices

Food prices in any one year are influenced for the most part by (a) farm product supplies, (b) marketing sector costs, and (c) factors affecting consumer demand. The food price situation in 1978 is an excellent example reflecting the importance of each of these factors.

Grocery store prices for 1978 will likely average about 10 percent higher than in 1977. Farm product prices, now expected to be about 15 percent higher than in 1977, will account for about half the increase.

This year's increase, due to the impact of farm prices, was greater than we originally expected. The increase was partially due to farm program changes designed to move grain prices above the depressed levels of last fall. Severe weather last winter and spring affected the pig crop. Spring floods affected the availability of some fruits and vegetables. Thus, the two largest weights in the food-at-home component of the CPI were those most greatly impacted. Because we cannot control the weather, we must develop public programs to moderate its effect on agricultural production.

The farmer-owned grain reserve we instituted this past year is an example of what more can be done. Such a program is not designed to stabilize grain prices but to eliminate the extreme highs and lows in grain prices, and, by doing so, help eliminate the extreme volatility in meat supplies and prices as well.

Marketing costs, accounting for about 70 percent of retail food costs, increase at about the same rate of inflation as we have in the general economy. Therefore, when we have a 7 percent rate of inflation as we do this year, we will have nearly a 5 percent increase in the retail cost of food due to higher marketing costs alone.

The bill for marketing food has increased each year, from $31.5 billion 25 years ago to a projected $135 billion in 1978, an increase of 328 percent (table 2). While there has been a steadily increasing quantity of food, there also have been increases in the per unit costs of marketing. In 1950 payments for marketing costs were 1½ times the farm value of the personal consumption expenditures for food. Today marketing costs are more than twice the farm value.

Since 1963, labor, packaging, and profits have all increased their percentage in the total marketing bill for foods. In addition, the percent changes in these components is greater than the year-to-year percent changes in retail food prices. Labor is the major contributor to food marketing costs, accounting for 45 to 48 percent of the total bill in recent years. In 1977 the size of the labor component alone was about $60 billion and costs for labor continue to increase at a rate of 10 percent per year.

Packaging costs are the second most important component, fluctuating between 12 and 13 percent of the total. Packaging cost consumers $16 billion in 1977. Year-to-year percent changes in packaging costs have also been greater than 10 percent since 1974.

Table 2.--Contribution of Food Prices to Inflation

Year	Change in food prices	Contribution to overall inflation
	Percent	Percentage points
1950	---	---
1951	+11.1	+2.7
1952	+1.8	+.4
1953	-1.5	-.4
1954	-.2	-.1
1955	-1.4	-.3
1956	+.7	+.2
1957	+3.3	+.8
1958	+4.2	+1.0
1959	-1.6	-.4
1960	+1.0	+.2
1961	+1.3	+.3
1962	+.9	+.2
1963	+1.4	+.3
1964	+1.3	+.3
1965	+2.2	+.5
1966	+5.0	+1.2
1967	+.9	+.2
1968	+3.6	+.9
1969	+5.1	+1.2
1970	+5.5	+1.3
1971	+3.0	+.7
1972	+4.3	+1.0
1973	+14.5	+3.5
1974	+14.4	+3.5
1975	+8.5	+2.0
1976	+3.1	+.8
1977	+6.3	+1.5
1978 (P)	+.10	+1.8

The proportion of the food marketing bill accounted for by transportation costs has also increased since 1967, comprising between 7 and 8 percent of the total food marketing bill. Here again, the annual percent changes have exceeded 10 percent since 1974. The total cost of transportation in the food marketing bill was $9 billion in 1977.

Profits (before taxes) have increased steadily as a proportion of the bill up to 7 percent of the total, about $8 billion.

Advertising, a small but controversial marketing cost (2-3 percent), has shown a slight decrease in relative value in recent years. Even so, the cost of food advertising was 88 percent greater in 1976, totalling $2.46 billion, than in 1963 at $1.31 billion.

The influence of consumer demand factors on retail food prices is also important but more difficult to isolate. Changing lifestyles, smaller family units, generally improved economic conditions, and the increased number of multiple wage earner households are having an effect on eating habits and food prices. There is some evidence to suggest that the rapid increase in meat prices in 1978 was influenced in an important way by stronger-than-expected consumer demand.

Food Prices Through 1979

Retail food prices are essentially unchanged during the July-September quarter, following their rapid increase during the first six months of this year. Prices actually declined in July and held even in August but the September Producer Price Index (formerly the Wholesale Price Index) did show increased prices for some food products. The September PPI may be an early warning that further increases in retail food prices may develop as we move into the fall and winter months.

The food price outlook remains largely dependent upon changes in marketing margins and livestock production patterns and expectations. If

livestock slaughter is as expected, and if the food transporting, processing, distributing and retailing sector holds marketing margins in check, retail food prices could hold at about their current levels through the remaining months of 1978.

Looking ahead to 1979 food prices is more risky. As is always the case, unpredictable climatological and biological factors could easily change the food price story a year from today. None of us can know for sure whether they will. But we each want to have the benefit of the best information now available.

As I explained earlier, the availability of farm products, the rate of change in marketing costs and the influence of consumer demand factors will together determine 1979 food prices. Because we are nearing the "low point" in the cattle cycle, we can expect further increases in meat prices. Prices for dairy products and sugar will probably increase because of policy actions. On the other hand, the 1979 feed grain crop is above expectations and feed grain prices are lower than we expected. Barring weather problems, supplies of fruits and vegetables in 1979 will be ample. All totaled, these factors could combine to push next year's farm prices 5 to 10 percent above the 1978 levels.

Increased costs for marketing services will be heavily dependent upon the rate of inflation in the general economy, the results of 1979 wage settlements and any changes in the energy cost situation. If the macro economic forecasters are correct, inflation next year will still be 6 to 8 percent. Price inflation in the general economy alone implies a 4 to 5 plus percent increase in food prices for 1979. Foreign food and fish prices are expected to be higher in 1979. They are likely to add at least 1 percent to the overall rate of food price inflation.

While an admittedly still formidable list of uncertainties exists,

it is unlikely that 1979 food prices could end the year less than 6 percent higher than in 1978. At the other extreme, a tight supply scenario, especially for meat and fresh fruits and vegetables, with adverse weather at crucial points in the year the key factor, it is possible to see food prices as much as 11 percent higher.